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Pursuant to 47 C.F.R. §§ 1.743(c), 1.913(c), 5.54(c), the preceding document is a copy of the original signed affidavit, which was filed as an attachment to Exhibit 2 to the Form 490 applying for the Commission's consent to transfer control of Part 22 licenses held by Detroit SMSA Limited Partnership from Ameritech Corporation to SBC Communications Inc. That Form 490 was filed concurrently with this application.

Affidavit of
Richard Schmalensee and
William Taylor

AFFIDAVIT OF RICHARD SCHMALENSEE AND WILLIAM TAYLOR

COMMONWEALTH OF MASSACHUSETTS	)	
	)	
	)	SS:
	)	
COUNTY OF MIDDLESEX	)	

Richard Schmalensee and William Taylor, being duly sworn, depose and say:

Richard Schmalensee is the Gordon Y. Billard Professor of Economics and Management at the Massachusetts Institute of Technology (MIT), Interim Dean of the MIT Sloan School of Management, and Director of MIT's Center for Energy and Environmental Policy Research. He also is a Special Consultant to National Economic Research Associates, Inc. and has served as a Director of the Long Island Lighting Company, a Member of the EPA's Environmental Economics Advisory Committee, and Chairman of the EPA's Clean Air Act Compliance Analysis Council. He served as a Member of President Bush's Council of Economic Advisers with primary responsibility for domestic and regulatory policy, including environmental and telecommunications policy and for U.S. assistance to Central and Eastern Europe. He served for several years as a consultant to the Bureau of Economics of the Federal Trade Commission.

Dr. Schmalensee has done extensive research on aspects of industrial organization and antitrust policy, particularly nonprice competition and conditions of entry. He has also studied the telecommunications industry, the electric power sector and general issues of regulation and regulatory reform. He has testified in both federal and state courts, before several Congressional committees, and before the Federal Trade Commission, and he has served as a consultant on regulatory and competitive issues to numerous organizations in the United States and abroad.

He received his S.B. and Ph.D. degrees in economics from MIT and taught for some years at the University of California, San Diego. At MIT, he teaches graduate courses in industrial organization, its applications to management decisions, government regulation and government/business relations. He has published over 60 articles in professional journals, including *The American Economic Review*, *The RAND Journal of Economics*, *The Harvard Law Review*, *The Journal of Econometrics*, *Public Utilities Fortnightly*, *Econometrica*, *The Journal of Law and Economics*, *The Journal of Industrial Economics*, *The Economic Journal*, *The Antitrust Law Journal*, *The International Journal of Industrial Organization*, *The Quarterly Journal of Economics*, and *The Journal of Economic Perspectives*.

He is the author of *The Economics of Advertising* and *The Control of Natural Monopolies* and co-author of *Markets for Power*. He is also co-editor of the *Handbook of Industrial Organization* and founding editor of the MIT Press Regulation of Economic Activity monograph series. He has served on the editorial boards of *The American Economic Review*, *Zeitschrift fur Nationalokonomie*, *The International Journal of Industrial Organization*, *The Journal of Economic Perspectives*, *Recherches Economiques de Louvain*, and *The Journal of Industrial Economics*. He has served on the Executive Committee of the American Economic Association and is a Fellow of the Econometric Society and the American Academy of Arts and Sciences.

William Taylor is a Senior Vice President of National Economic Research Associates, Inc. (NERA), head of its telecommunications economics practice and head of its Cambridge office. He received a B.A. degree in economics, magna cum laude, from Harvard College in 1968, a master's degree in statistics from the University of California at Berkeley in 1970, and a Ph.D. in Economics from Berkeley in 1974, specializing in industrial organization and econometrics. He has taught and published research in the areas of microeconomics, theoretical and applied econometrics, and telecommunications policy at academic institutions (including the economics departments of Cornell University, the Catholic University of Louvain in Belgium, and the Massachusetts Institute of Technology) and at research organizations in the telecommunications industry (including Bell Laboratories and Bell Communications Research, Inc.). He has participated in telecommunications regulatory proceedings before state public service commissions, the Federal Communications Commission, the Canadian Radio-Television and Telecommunications Commission and federal and state legislative bodies on numerous topics in telecommunications economics including public interest assessments of mergers of major local, long distance and cable suppliers.

His articles have appeared in numerous telecommunications industry publications as well as *Econometrica*, the *American Economic Review*, the *International Economic Review*, the *Journal of Econometrics*, *Econometric Reviews*, the *Antitrust Law Journal*, *The Review of Industrial Organization*, and *The Encyclopedia of Statistical Sciences*. He has served as a referee for these journals (and others) and the National Science Foundation and has served as an Associate Editor of the *Journal of Econometrics*.

We have been asked by SBC Communications, Inc. ("SBC") and Ameritech Corporation ("Ameritech") to assess the likely effect of the proposed merger of SBC and Ameritech on consumers and competition in the telecommunications markets served by them. In the attached report, using conventional economic models and tools, we conclude that the merger can have no adverse effect on current competition in the telecommunications markets served by SBC and Ameritech and is unlikely to have any adverse effect on competition in those markets in the future. On the contrary, we conclude that by reducing costs and by facilitating entry by the combined firm into out-of-region local exchange markets—and reciprocally inducing entry of other ILECs into the local exchange markets of SBC and Ameritech—the merger is likely to provide substantial benefits to consumers.

Richard Schmalensee

William E. Taylor

William Taylor

Subscribed and sworn to before me this 21st day of July, 1998.

Christiana Olsen

Notary Public

COMMENTS CONCERNING THE PROPOSED

SBC-AMERITECH MERGER

Report of Richard Schmalensee and William Taylor
National Economic Research Associates, Inc.
July 21, 1998

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REPORT OF RICHARD SCHMALENSEE

AND

WILLIAM TAYLOR

I. THE ECONOMIC FRAMEWORK FOR MERGER ANALYSIS

1. The Federal Communications Commission ("FCC" or "Commission") articulated its standards for merger review in its decisions in the SBC-Pacific Telesis and Bell Atlantic-NYNEX cases.[1] There, the Commission determined that to approve a proposed merger, it must find the transaction to be in the public interest, where the public interest standard encompasses the "broad aims" of the Communications Act, including, among other things, supporting a procompetitive, deregulatory national telecommunications policy framework. The Commission therefore considers the effect of the merger on competition, using, in part, the *Merger Guidelines* framework employed routinely by the U.S. Department of Justice and Federal Trade Commission to assess the welfare effects of proposed mergers and, in part, a framework specific to telecommunications markets including effects of regulation, high current concentration, rapid technological change and anticipated changes in market structure stemming from the implementation of the procompetitive requirements of the Telecommunications Act of 1996.[2]

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[1] In re *Applications of Pacific Telesis Group and SBC Communications, Inc.*, Memorandum Opinion and Order, Report No. LB-96-32, released January 31, 1997. In re *Applications of NYNEX Corp. And Bell Atlantic Corp Consent to Transfer Control of NYNEX and its Subsidiaries*, Memorandum Opinion and Order, ("Bell Atlantic-NYNEX Order"), CC Docket No. 97-286, released August 14, 1997.

[2] Bell Atlantic-NYNEX Order, ¶¶2-7.

2. Mitigating possible competitive harms from a merger are merger-specific efficiency gains that improve market performance, resulting in lower prices, improved service quality and the offering of new or enhanced services.[3] Likely sources of such gains include:

- economies of scale and scope which may result because of the increased size of the merged firm, through synergies in operations and management, or from expansion in output since markets available to the merged firm are larger than those served by the firms separately;
- more competitive prices, higher quality service and increases in output which may result from increased competitiveness in certain markets; and
- new products and services which may be developed in greater number and/or at greater speed because the return on product development may be higher in the merged firm due to improved incentives or scale economies.

3. The competitive analysis begins by identifying the relevant product and geographic markets in which the merging parties *currently* participate. Within those markets, it then measures the effect of the merger on market structure—the number and size distribution of firms competing in a market—as an indicator of the likely effect of the merger on competition in those markets. Economists consider both the level of and the change in market concentration. If the merger significantly increases concentration in a concentrated market, then the analyst must examine other factors affecting competition, including the ease of entry of new firms into the market, the pricing history of firms currently in the market, and the ease with which consumers can substitute away from the service in question in response to an increase in price. As described in Section III below, after divestiture of certain overlapping cellular properties, there will be no meaningful current, actual competition between operating entities of SBC and Ameritech in any product or geographic market, so these considerations do not apply.

4. A separate competitive analysis is applied to potential, rather than actual, competition, assessing the degree to which the merger is likely to eliminate an "actual potential" competitor whose likely entry in the future (whether perceived or not by current competitors) would reduce

[3] *Ibid.*, ¶158

future market concentration and help to control future price increases in the market. The effects of potential competition are necessarily more speculative than those of actual competition; consequently, a finding that a merger is likely to have anticompetitive effects based purely on its effect on potential competition is relatively rare in antitrust enforcement.

5. In summary, if a proposed merger does not increase concentration in an already-concentrated market or eliminate a unique source of potential competition in such a market, the merger is treated as competitively benign. Such treatment accords with economic theory: if markets are unconcentrated or the merger does not substantially increase concentration in a market or significantly slow deconcentration and concomitant price decreases, then the merger is unlikely to increase the market power of the participants or the likelihood that the merged firm could raise prices or reduce the level of service quality.

6. After the required sale of overlapping cellular properties, SBC and Ameritech are not actual competitors of any consequence in any telecommunications market. Moreover, they are not significant potential competitors in any market because they possess no unique advantage in entering each other's markets compared with the many other potential entrants. On the contrary, SBC and Ameritech are disadvantaged with respect to entry compared with other telecommunications suppliers that already possess facilities, customers and brand name recognition in the markets to be entered. Thus, the merger poses no threat to actual or potential competition in any market.

7. On the contrary, the merger is likely to increase facilities-based local exchange competition both in-region and out-of-region. A consequence of the merger will be the implementation of a plan to enter local exchange markets in 30 major out-of-region MSAs initially in order to supply current large business customers with end-to-end services and subsequently to expand upon that footprint to serve other business and residential customers. If perceived as likely to be successful by its competitors, the plan should encourage reciprocal facilities-based local entry in the SBC-Ameritech region (and elsewhere) by other local exchange carriers also seeking to serve their large business customers wherever they do business.

II. BENEFITS FROM THE SBC-AMERITECH MERGER ARE LIKELY TO BE SUBSTANTIAL.

A. Cost Savings

8. The economics literature does not suggest that current Regional Holding Company (RHC) sizes exceed minimum efficient scale. Econometric evidence of scale economies among telecommunications firms much larger than SBC or Ameritech suggest positive scale economies with no evidence of diseconomies of scale. Nearly every other country (except Canada) provides local exchange service—prior to competition—through a single geographically integrated national supplier. This supports the observation that diseconomies of scale for local exchange service are unlikely at current firm sizes.

9. The large number of recent mergers and joint ventures throughout the telecommunications industry further suggests that current-sized firms do not exhaust the available economies of scale and scope. The primary examples of such mergers include AT&T-McCaw-TCG-TCI, MCI-WorldCom-MFS-Brooks Fiber-UUNet and Bell Atlantic-NYNEX. Joint ventures include AT&T WorldPartners and Deutsche Telekom-France Telecom-Sprint's Global One and Unisource.

10. Consider the pattern of these mergers and agreements. They appear not to be simple horizontal mergers in which the parties gain a larger share of a given market. Instead, they are either combinations of companies with similar services but which operate in different geographical areas, or they are combinations of companies which operate in overlapping areas but offer different services. The SBC-Ameritech merger is similar in that respect. It combines companies that serve different geographical areas, and, as explained below, the resulting greater return from new service development will enable them to expand service offerings in both areas.

11. There are several sources of cost savings that are likely to result from the merger:

- <u>economies of scale</u>: reduced unit costs by spreading fixed costs over a larger base of output; lower input prices through joint purchasing and volume discounts;

- economies of scope: reduced unit costs by supplying a full complement of telecommunications services, spreading R&D costs, for example, over all services that benefit from basic telecommunications research, spreading marketing costs of attracting customers over a wider range of services for those customers;

- net cost savings from integration: rationalization of duplicative expense and capital expenditures including (i) reduced staff expense for overlapping functions, (ii) redundant expenses for information systems and advertising, and (iii) reduced capital costs from additional volume discounts, reduced test labs and market trials.

12. As part of its pre-merger due diligence investigations, SBC developed estimates of the likely cost savings that would result from the merger, focusing on the savings from eliminating redundancies between the companies in three areas:

- Staff and Support redundancies: corporate oversight and governance,

- Systems and Infrastructure Support redundancies, and

- capital expenditure efficiencies: volume discounts, reduced redundancies in market and engineering trials.

By the third year after closing, annual cost savings stemming directly from the merger were estimated to include $1.2 billion in expense savings, $250 million in capital cost savings and $300 million from reduced costs and expanded revenue from the combined long distance companies, after they are permitted to enter the in-region interLATA market. In addition, application of best marketing practices between the Companies is estimated to increase revenue from new and existing services by $750 million per year.

13. In addition to these projected savings, there are likely to be additional cost savings that have not been quantified. Some of these additional savings would come from the following sources:

- The two companies can compare the cost, effectiveness, and quality of each other's processes. If SBC has a better practice for some process than Ameritech does, then Ameritech can deploy it, and vice versa. Each Company has an incentive to find the best match of practices because the resulting reductions in cost or increases in revenue will likely lead to higher profits. This reciprocal adoption of best practices is far more effective within a company than between two independent companies. Within a company, cooperation is greater, concerns about proprietary or competitively-sensitive information are eliminated, and the information about each other's processes is more reliable. The result of this reciprocal adoption of best practices is lower costs and accelerated improvements in service quality to customers for both companies.[4]

- The merger would increase the effectiveness of investment in research and development by (i) joint management of R&D, (ii) spreading R&D costs over a larger base of products and services, and (iii) capturing the benefits of basic research in a larger company. In addition, the merger would improve the development of new services: supplying more of them, more rapidly and at lower cost.

- The merger would create a more effective entrant into the long distance market. The merged company's greater size will lead to lower costs and thus lower prices to toll customers. Further, the company could avoid redundant development and maintenance of operations systems that support the long distance business, including fraud detection systems, customer service support systems, and toll recording, rating, billing, and collection systems. Such operations systems are very expensive. For instance, MCI reportedly spends a billion dollars a year to develop software for new services like its "Friends and Family" service.[5] The company's improvements in its new service development process would similarly help its entry. As a more effective long distance competitor, it would be more likely to increase the competitiveness of the long distance market, reduce market prices, and stimulate innovation. Further, as a larger purchaser of interexchange carrier services for resale, it would be able to negotiate lower prices for its bulk transport purchases. This effect would put further downward pressure on long distance prices, to the benefit of consumers. Combining enhanced revenues, economies of scale, lower costs from higher-volume purchases of wholesale long distance services and avoidance of redundancy where the merged firm constructs facilities or uses existing facilities would amount to an additional $300 million annually.

B. Benefits from more effective competition

14. Large business customers with sophisticated network needs increasingly purchase from national or global suppliers. A regional supplier is disadvantaged in competition for local exchange or global services because large multi-location customers often prefer to deal with a single supplier. The merger would place the combined company at less of a disadvantage

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[4] While concerns about service quality sometimes arise in merger evaluations, they would be misplaced in the current proceeding. The SBC-Ameritech merger provides an opportunity to accelerate improvements in service quality.

[5] "Long Distance: Innovative MCI Unit Finds Culture Shock in Colorado Springs," *Wall Street Journal* (June 25, 1996), p. A1.

compared to competitors the size of AT&T and its WorldPartners alliance, the Deutsche Telekom-France Telecom-Sprint Global One, Unisource and whatever comes of the BT-MCI "Concert" joint venture after the MCI-WorldCom merger is settled. Other comparable multinational telecommunications firms include Nippon Telephone and Telegraph, France Telecom, British Telecom and Telecom Italia. Adding another potential supplier to this concentrated market has obvious procompetitive benefits in the market serving large business customers. In addition, there will be long-term benefits from enhanced competitiveness among national and global suppliers that will accrue even to customers that only purchase local exchange service, because SBC and Ameritech will be able to retain contribution from high-volume customers that they would otherwise have lost as stand-alone regional telephone companies.

15. The merger also makes possible the National-Local strategy of supplying local exchange services on a facilities basis to the Company's largest business customers in as many of their locations as possible. As described in Mr. Kahan's affidavit, the Plan contemplates first providing a single facilities-based source for communications services for the 1000 largest companies in the U.S., customers who typically demand a sophisticated array of network services designed individually to supply the mix of services (voice, data) required at the customer's worldwide locations. Second, the Plan expands facilities from that base to serve smaller business and residential customers, and third, the Company proposes to build a new integrated packet-switched network to provide high-speed data services along with Internet access capability to both business and residential customers.

16. The Plan promises additional facilities-based local exchange competition from what has heretofore been regarded as an unlikely source: entry by out-of-region ILECs.[6] Such a strategy will enable the combined companies to compete in local exchange markets against other companies—mainly IXCs—that currently serve their customers on a national and global basis.

[6] Out-of-region ILECs have generally been discounted as likely potential entrants because they have no existing customer base from which to expand (unlike IXCs, CAPs, and cable companies), no facilities to share with existing services and little brand equity out-of-region.

In addition, entry in this particular form will motivate the affected ILECs (e.g., Bell Atlantic, BellSouth, US WEST) to retaliate by competing initially for large business customers in SBC-Ameritech territory. However, as described in Dr. Carlton's affidavit, execution of the Plan is contingent on the merger. The ability to undertake and manage the massive expansion required to follow a significant fraction of the demand of the largest business customers depends very much on size. Managing a strategy of entering geographically-dispersed markets initially to serve a relatively narrow base of customers requires a large, flexible pool of management and employee skills if such entry is to be cost-effective. A substantial base of current customers and revenues is necessary to maintain earnings growth and spread risk while following customers into out-of-region local markets. No other ILEC or CLEC has announced an out-of-region local competition initiative of comparable scope, and, in the U.S., the only carriers currently competing on a national-local basis are the vertically-integrated IXCs (AT&T-TCG-TCI and MCI-WorldCom-MFS-UUNet-Brooks Fiber).

17. Of the merger cost savings, some will go to stockholders. The remainder will likely be passed through to consumers in the form of improved services, lower prices, more rapid introduction and dissemination of new services, and additional options and packages of services as competitive forces require. It would be unusual for a firm not to use some of its cost reductions to expand its markets, so that the sum of the benefits to stockholders and consumers will likely exceed the merging companies' own cost savings. The reason is that one firm's price reductions or quality improvements will tend to force competitors to lower their prices or improve their products as well. Consequently, all consumers in those markets benefit, not just the customers of the merging companies. This effect can be especially magnified in markets such as interLATA long distance where the merging companies have small market shares. A price reduction for their small fraction of industry output can affect prices in the whole market, greatly expanding the aggregate benefit to consumers.

C. Less costly and more rapid introduction of new technologies and services

18. The merger will stimulate less costly and more rapid development of new telecommunications products and services because the return to the introduction of new products and services will be higher in the merged firm. The companies will experience (i) a reduction in risk from increased size, (ii) savings in joint purchases of capital equipment, (iii) sharing costs of technical and marketing trials, and (iv) elimination of redundant support systems. The merger will permit the expanded firm to purchase a more diverse mix of technologies and greater use of different suppliers without sacrificing the financial benefits of volume purchasing.

19. First consider the sources of cost savings. Currently, both companies have new service development efforts, which consist of many complex and costly steps. At all stages of the process, cost savings can occur by eliminating duplicative efforts and exploiting economies of scale, including lower equipment prices from vendors who offer volume discounts. Another benefit from the greater size and diversity of the merged companies' markets is the potential reduction in risk of new service offerings. The success of new services is always uncertain. Much of the merger savings are likely to occur in the fixed initial costs of new service development. For a larger firm, the fixed costs are smaller relative to the variable costs, so, if market demand for a new service proves to be disappointing, less investment is at risk per unit of output. Further, the merged company's larger size makes it more economical to experiment with different services, features, technologies, and vendor equipment, without sacrificing substantial volume purchases.

20. Second, consider the implications for the pace and intensity of new service introductions. The merged company's new service development efforts will be more profitable than they would be for the two separate companies. After the merger, the new company will be

significantly larger than either SBC or Ameritech individually.[7] Because most of the new service development costs are insensitive to the scale of deployment, for any given service, the return on a new service development effort will be substantially greater than it would be for the two individual companies. This greater profitability of its new service development efforts will stimulate the merged firm to accelerate development of each potential service and to develop more services. In its decision in the Bell Atlantic–NYNEX merger, the FCC expressed the concern that elimination of duplicate R&D would also eliminate a source of non-price competition that could give customers added service variety and quality[8]. That concern is largely absent in the current case because while SBC has a research division, Technology Resources, Inc. ("TRI"), Ameritech has no equivalent organization, and the firms do not compete through research and development efforts.

21. A more profitable new service development program would benefit consumers directly. Any new service generates consumer surplus as it more effectively meets customers' needs than existing services did, and consumer surplus gains from new services are surprisingly large.[9] The communications market is more dynamic than most other markets, with rapid changes in the technology, market needs, and competitive alternatives. The potential gains to the merging companies and to consumers from improved incentives to develop new services are much more important than they would be in most other industries. The more efficient service development program associated with the merger would also enable the Company to make a more effective challenge to the market dominance and high profit margins of the big three long distance carriers.

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[7] 1997 revenues were $25 and $16 billion for SBC and Ameritech, respectively, according to their Annual Reports.

[8] Bell Atlantic-NYNEX Order, ¶ 171.

[9] For instance, according to one estimate, the introduction of voice mail service increased consumer welfare by $1.2 billion in 1994. See J.A. Hausman and T.J. Tardiff, "Valuation of New Services in Telecommunications" (1995).

D. International and Global Opportunities

22. As their major customers expand across national boundaries and continents, telecommunications companies are responding by consolidating through mergers, alliances and joint ventures. Examples include (i) AT&T's "WorldPartners" alliance between AT&T and 17 foreign carriers, (ii) Sprint's "GlobalOne" alliance with Deutsche Telekom and France Telecom, (iii) Unisource—an alliance among 4 European PTTs and (iv) Cable & Wireless, which has ownership interests in various foreign local, long distance and wireless companies and which recently announced its acquisition of MCI's global Internet business. Through these consolidations, telecommunications companies can offer to supply multinational customers with end-to-end trans-border services, which is exceedingly valuable to many large business customers whose networks require consistent standards and single points of contact in case of failure. As seen in the case for the National-Local Plan, following multinational customers to their many locations is an attractive business plan for companies with sufficient financial and managerial resources to undertake the required investment and expansion. Regional carriers will increasingly find themselves at a disadvantage in competing for national and multinational accounts, and the proportion of traffic in such accounts is growing rapidly.

23. While SBC's incentive to expand globally into foreign local markets is primarily to serve its multinational business customers, the benefits from that expansion are not confined to large business customers. As SBC's network expands geographically and technologically through the three portions of its National-Local plan to keep pace with those of its global competitors, small business and residential customers who depend on SBC's facilities for retail services they buy from SBC or resold services they buy from others will benefit from the increased number and functionality of the services they receive and the prices they pay.

E. Summary of likely benefits from the merger.

24. Likely efficiency gains from the merger include a sizable reduction in total corporate overhead expenses and capital expenditures through a rationalization of redundant support activities. Additional cost reductions and more rapid improvements in service quality can be realized through the mutual adoption of each company's best practices. Increased profitability

from a wider base of support for research and new service development would bring more new services to customers more rapidly. Finally, local exchange customers benefit from the enhanced ability of the merged firm to compete with national and global suppliers in local exchange and long distance markets.

III. THE SBC-AMERITECH MERGER WILL NOT ELIMINATE ACTUAL COMPETITION IN ANY ECONOMIC MARKET.

25. Ameritech and SBC currently supply traditional telecommunications services to business and residential customers in distinct geographic regions. Ameritech serves portions of the states of Illinois, Michigan, Indiana, Wisconsin and Ohio, while SBC's territory includes parts of Missouri, Arkansas, Oklahoma, Texas, Kansas, California and Nevada. Within their respective service territories, Ameritech and SBC provide both wireline and wireless telecommunications services. Wireline telephone services include customer access, local usage, vertical services (*e.g.,* call waiting, call forwarding), business services (*e.g.,* Centrex services), private line, public (coin) telephone, intraLATA long distance services, and exchange access services. Prices and terms and conditions of most wireline services are regulated by individual state public utility commissions and by the FCC. Wireless offerings include cellular, PCS and paging services, whose prices and terms and conditions are generally not controlled by regulatory agencies. Outside their service territories, both companies have begun to resell long distance services, and both companies own wireless (cellular or PCS) properties.

26. In its Bell Atlantic-NYNEX Order, the Commission began its analysis by identifying the relevant product and geographic markets within which it then appraised the effects of the merger on actual and potential competition. Based on the demand substitution approach to product market definition used by the *Merger Guidelines*, the Commission focussed on three relevant markets: local exchange and exchange access services, long distance services, and bundles of those services. To that collection, we would tentatively add a fourth—wireless services—that were unnecessary to consider in the Bell Atlantic-NYNEX merger because the merging companies already provided wireless services through a joint venture. Our treatment of wireless services as a separate market is tentative because—as the Commission itself has

noted—wireless services, particularly PCS, have the potential to become substitutes for wireline local exchange services as prices of wireless services fall.[10]

27. The Commission found that the relevant geographic markets in the Bell Atlantic-NYNEX case were areas "in which all customers in that area will likely face the same competitive alternatives for a product" and identified LATA 132 as a relevant market of particular concern.[11] In the current case, the only geographic markets in which the merger could have any effect on actual or potential competition are the St. Louis and Chicago LATAs where SBC and Ameritech own competing cellular systems and are respectively the incumbent wireline carriers (i.e., SBC is the ILEC in St. Louis and Ameritech is the ILEC in Chicago).[12] In addition, the FCC identified three classes of customers for which it performed separate analyses in the Bell Atlantic-NYNEX Order: residential and small business customers, medium-size businesses and large business/government users.[13]

28. The merger of SBC and Ameritech will not combine any entities that compete to any meaningful extent with one another in any relevant geographic market for any product or service. The wireline local exchange companies of SBC and Ameritech currently serve discrete territories in their respective states. Their territories do not overlap anywhere and they provide

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[10] "PCS providers appear to be positioning their service offerings to become competitive with wireline service, but they are still in the process of making the transition 'from a complementary telecommunications service to a competitive equivalent to wireline services.'" *In the Matter of Application by BellSouth Corporation, et al. Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Louisiana*, Memorandum Opinion and Order (CC Docket No. 97-231) released February 4, 1998, at ¶73.

[11] Bell Atlantic-NYNEX Order at ¶54.

[12] There are a dozen other MSAs and RSAs in Chicago, St. Louis and central Illinois in which SBC and Ameritech cellular license areas overlap. FCC Rules require the removal of all of these overlaps.

[13] *Ibid.*, at ¶53.

local exchange services in distinct geographic markets.[14] There are geographic markets in which SBC and Ameritech currently provide cellular services which overlap in Chicago, St. Louis and central Illinois, but FCC rules require that such properties be sold to unrelated purchasers. Thus, the merger will not combine any entities which currently compete in a relevant geographic and product or service market. Further, Ameritech's cellular service currently competes with SBC's Cellular One service in St. Louis and has contemplated offering resold wireline local exchange services to its cellular customers in St. Louis. Once one or the other cellular asset is sold, however, an unrelated entity will own and manage a cellular franchise and whatever local exchange business it can profitably supply in St. Louis. However effective cellular companies may be as competitors to the wireline local exchange company, the merger—conditioned on the sale of the competing cellular carrier—will not diminish that source of competition.

29. Although SBC and Ameritech both offer long distance services out-of-region (and thus nominally could compete in some out-of-region states), the effect of the merger on competition in the national long distance market is imperceptible for two reasons. First, SBC and Ameritech have almost negligible market presence as long distance carriers in out-of-region states, competing as two small resellers among several hundred resellers in a national market dominated by four nationwide facilities-based firms (of which two are in the process of merging).[15] Second, until SBC and Ameritech are permitted to provide in-region long distance service, their primary incentive to supply long distance services out-of-region as a reseller is to provide full service to their in-region calling card customers when they travel out-of-region.

[14] Ameritech served out-of-region locations for one large business customer on a pilot basis, comprising a small number of resold lines in California, New York and Texas. (Weller Affidavit, ¶ 32) While it has not pursued similar arrangements with other customers, it continues to supply service to the original customer. Because Ameritech apparently abandoned plans to roll out the service to other such customers and because those customers already have alternatives to ILEC services, the effect of the merger on competition would be negligible.

[15] SBC provides cellular long distance in Illinois and Indiana where Ameritech cannot while Ameritech provides cellular long distance in Missouri where SBC cannot.